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Supreme Court of Canada Releases Landmark Decision in Tercon Case

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Introduction

On February 12, 2010 the Supreme Court of Canada released its highly anticipated decision in the *Tercon Construction Ltd. v. British Columbia (Transportation and Highways)* 2010 SCC 4 (“Tercon SCC”). In its reasons for decision the Court reversed the decision of the B.C. Court of Appeal and held that the particular exclusion clause contained in the request for proposals (“RFP”) did not permit the Ministry to accept a non-compliant bid.

However, while the Court held that the exclusion clause did not apply to the facts of this case, it left open the possibility of more broadly worded exclusion clauses being sufficient to limit liability, including liability for breach of a duty of fairness.

The Court also affirmed the continued application of the obligations imposed on the tendering and procurement process by the courts, beginning with the decision of the Supreme Court of Canada in *The Queen (Ont.) v. Ron Engineering*, [1981] 1 S.C.R. 111 (“*Ron Engineering*”). In *Ron Engineering*, the Court held that a bid submitted in the tendering process results in a contract- Contract A- while the awarding of the tender results in a separate contract- Contract B. Following

Ron Engineering three key principles in the law of tendering emerged:

- a) Only a compliant tender can be accepted by an owner;
- b) The lowest compliant tender should be accepted; and
- c) The owner owes bidding contractors a duty of fairness in analyzing the tender bids.

These principles operate to limit the discretion of the owner in awarding Contract B and ensure the fairness and transparency of the tendering process. However, the application of these principles was modified by the inclusion of exclusion clauses or “privilege” clauses by owners in tendering documents. In *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.* [1999] 1 S.C.R. 619 (“*M.J.B.*”), the Supreme Court of Canada held that the inclusion of an exclusion clause in the invitation for tender that provided that “the lowest or any tender shall not necessarily be accepted” meant that the owner no longer had an obligation to accept the lowest bid. However, later decisions clarified that such an exclusion clause does not give an owner the ability to accept any bid; a decision to accept a bid other than the

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lowest bid must be done in good faith and based on objective reasons (see e.g.: *Sound Contracting Ltd. v. City of Nanaimo*, 2000 BCCA 312).

The Supreme Court of Canada's decision in *Tercon SCC* leaves open the possibility for a properly crafted exclusion clause to permit an owner to breach a fundamental term of Contract "A", such as the requirement to only accept a compliant bid. However, the Court stressed that such a result would require a clear and unequivocal exclusion clause.

Supreme Court of British Columbia

The dispute at issue in *Tercon Contractors Ltd. v. British Columbia (Ministry of Transportation and Highways)*, 2006 BCSC 499 ("*Tercon BCSC*") arose from an RFP by the B.C. Ministry of Transportation and Highways (the "Ministry"). In *Tercon BCSC*, the Court suggested that tendering law may in some circumstances apply to a procurement process that is not, strictly speaking, a tendering process.

Tercon was one of six qualified proponents for the project and submitted the second lowest bid, and the lowest compliant bid. However, the Ministry awarded the contract to the lowest (non-compliant) bid. *Tercon*, as the lowest compliant bid proponent, sued the Ministry, claiming that the Ministry had breached its duty of fairness in awarding the contract to a non-compliant bid based on the principles outlined by the Supreme Court of Canada in *Ron Engineering*.

The B.C. Supreme Court agreed with *Tercon* and held that the submission of a proposal to the Ministry resulted in the formation of Contract "A" under the *Ron Engineering* analysis, and gave rise to a duty to reject non-compliant bids. The Ministry's failure to do so was a fundamental breach of Contract "A".

The trial judge then went on to consider the effect of the exclusion clause. The Ministry's RFP contained

the following exclusion clause to protect itself from liability:

[Para. 2.10] Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for any compensation of any kind whatsoever, as a result of participating in this RFP, and by submitting a proposal each proponent shall be deemed to have agreed that it has no claim. (*Tercon BCSC*, para. 140)

The court held that although the exclusion clause was ambiguous, it was "inconceivable" that the parties could have intended the exclusion clause to apply to a fundamental breach of Contract "A", such as occurred in this case. Consequently, the ambiguity was resolved in favour of the plaintiff, with the effect that the exclusion clause did not apply to the fundamental breach.

In *obiter dicta*, the trial judge went on to state that even if the exclusion clause included fundamental breaches, the clause should not be enforced on the basis that such enforcement would lead to an unconscionable result.

Court of Appeal

In *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2007 BCCA 592 ("*Tercon BCCA*"), the B.C. Court of Appeal overturned the B.C. Supreme Court's decision. The Court of Appeal held that while tendering law applied to the Ministry's procurement process, the all-encompassing exclusion clause provided in the RFP effectively barred *Tercon* from suing the Ministry for failing to reject the non-compliant bid. Furthermore, although the Court acknowledged the public policy concern of allowing a broad exclusion clause that can excuse acceptance of non-compliant bids, this was not an issue they were willing to address.

However, although *Tercon BCSC* was overturned based on the issue of the exclusion clause, the principles maintained in *Tercon BCSC* regarding tendering law and its application on RFPs and hybrid processes still stand. Therefore, *Tercon BCSC* still illustrates that tendering law can apply in some instances to a procurement process characterized by the owner as an RFP process. However, the decision turned on the specific facts of the case. The procurement process undertaken by Tercon amounted in substance to a tendering process, and the decision of the court in *Tercon BCSC* was to preclude an obvious subterfuge of the tendering process. Although the process used by the Ministry was referred to as an RFP process in the procurement documents, there were a number of features of the process that were very reminiscent of a formal tendering process.

Thus, *Tercon BCSC* suggests that tendering law may apply to what might be intended to be an RFP process, thereby significantly reducing the owner's flexibility. However, this issue may be meaningless if owners are allowed to insert an all-encompassing exclusion clause that prevents tenderers from suing them for any default including a fundamental breach.

Supreme Court of Canada Decision

In *Tercon SCC*, the Court agreed on the proper framework of analysis but divided on how to apply it. The Court held that when a plaintiff seeks to escape the effect of an exclusion clause the first issue is whether or not the exclusion clause applies to the circumstances. If the exclusion clause applies, the second issue is whether the exclusion clause is unconscionable and thus invalid. If the exclusion clause is valid and applicable, the only remaining question is whether the court should nevertheless refuse to enforce the exclusion clause due to overriding public policy concerns.

In applying this general framework, the majority of the Court held that the exclusion clause did not

apply to exclude Tercon's claim for damages. The exclusion clause only barred claims for compensation "as a result of participating" in the tendering process; it did not exclude damage claims resulting from the Province unfairly permitting an ineligible bidder to participate in the tendering process. In interpreting the exclusion clause, the Court noted that "the words of one provision must not be read in isolation but should be considered in harmony with the rest of the contract and in light of its purposes and commercial context" (at para. 64). The Court also had regard to the "special commercial context of tendering", particularly in cases of public procurement in interpreting the exclusion clause. In the result, the Court held, at para 78:

I cannot conclude that the parties, through the words found in this exclusion clause, intended to waive compensation for conduct like that of the Province in this case that strikes at the heart of the integrity and business efficacy of the tendering process which it undertook.

The Court also concluded that the doctrine of fundamental breach has no application and should be laid to rest. Binnie J. in a dissenting judgment (adopted by the majority on this point) noted that (para. 82):

Categorizing a breach as "fundamental" or "immense" or "colossal" is not particularly helpful. Rather the principle is that a court has no discretion to refuse to enforce a valid and applicable contractual exclusion clause unless the plaintiff (here the appellant Tercon) can point to some paramount consideration of public policy sufficient to override the public interest in freedom of contract and defeat what would otherwise be the contractual rights of the parties.

The Court also noted that the implied duties outlined in *Ron Engineering* and *M.J.B.* only arise where the dealings between the parties support an intention to be bound by such duties (*Tercon SCC* at paras. 17 and 23). On the facts of this case, the Court held that an implied duty of fairness applied and had been breached by the Province.

However, while the majority held that the exclusion clause had no application on the facts of this case, it left open the possibility for owners to exclude liability for breach of implied duties in future tendering cases with a clearly worded exclusion clause. The majority of the Court noted that “clear language is necessary to exclude liability for breach of such a basic requirement of the tendering process, particularly in the case of public procurement” (at para. 71).

Conclusion

This is the latest decision from the Supreme Court of Canada attempting to balance the interests of owners and tenderers involved in the tendering process.

Owners generally want to retain some flexibility and are uneasy about setting in motion a process that will prevent them from reserving the right to make the final decision. Owners also wish to retain an ability to react to unexpected tender results or to unexpected tenderers, whom the owners do not believe can complete the work on time and within the contract price. Occasionally, owners may even be tempted to use the tendering process for undisclosed purposes: for example, to set a budget instead of making a contract, or to pursue political

objectives which give consideration to factors other than price.

On the other hand, tenderers are concerned that favouritism not be shown to other tenderers, that arbitrary or capricious decisions not be made by the owner and that owners do not take advantage of innocent errors in their bids. Tenderers are willing to accept reasonable levels of competition, provided the “rules of the game” are clearly spelled out at the outset. Since preparing a tender can consume a great deal of time, effort and expense, tenderers do not want to waste their resources tendering when they have little or no chance of success.

In *Tercon SCC*, the Supreme Court of Canada overturned the Court of Appeal’s decision and held that the exclusion clause contained in the tendering documents did not apply to exclude liability on the facts of this case. In doing so, the court affirmed the principles and duties contained in *Ron Engineering* and stressed the need for fairness to all bidders as essential for the continued efficacy of the tendering process. However, the court also left open the possibility that exclusion clauses that are crafted more broadly will apply to limit liability of owners.

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